Commentaire

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1. Introduction

The paper under discussion ("European economic governance: the Berlin-Washington Consensus," *Cambridge Journal of Economics*, 2013; hereinafter, CJE), co-authored by Jean-Paul Fitoussi (JPF) and Francesco Saraceno (FS), was published during the second of the two crises (the international financial crisis and the "doom-loop" between the sovereign debt crisis and the crisis of the banking sector) that hit the euro area in the years 2007-2013. The contribution of JPF and FS is quite stimulating, for at least two reasons. First, it presents a pessimistic view on the possible evolution of the European monetary union; this negative evolution was not however borne out in the following period despite two further dramatic exogenous shocks (the pandemic and the Russian invasion of Ukraine) that affected the European Union (EU) at the beginning of 2020 and 2022, respectively. Second, the authors understand in advance one of the main weaknesses of the economic policies that were implemented by the European institutions after the international financial crisis. The former point should justify a criticism of their paper's content, whereas the latter should be considered an original contribution to the European debate. To make my comment still harder to design, these two points are connected, in the sense that the authors grasp the drawbacks of the European policies thanks to their critical view of the working of the EU's institutional and economic setting.

In Section 2, I will show that the authors' criticism relative to the EU economic framework is questionable from an analytical point of view and somewhat too extreme. In Section 3, I will emphasise that their critical view allows a well-thought-out assessment of the EU's economic weaknesses but, at the same time, hinders a perception of a possible positive evolution in the EU's economic policy. In the short conclusions, I suggest the risks and potentials of such an evolution.

2. Did the EU internalise the Washington consensus?

JPF and FS maintain that the EU "has gone very far in the internalisation of the original Washington Consensus," because the Maastricht Treaty and the evolution of European economic governance have been centred on "macroeconomic stability (balanced budgets and price stability)", "structural reforms aimed at increasing competition and openness", and the favouring of a long-term perspective dominated by aggregate supply over a short-term one in which aggregate demand would matter (CJE, p. 479). The implication drawn by the two authors is that the EU's economic construction has been inspired by a neoliberal approach. In the new Millenium, this approach is based on the new theoretical synthesis elaborated by combining the models of real business cycle, those centred on efficient market hypothesis, and those with nominal endogenous rigidities (see Clarida *et al.*, 2020). Despite the contribution of the new Keynesian strand based on market imperfections, this new synthesis has marked the triumph of the orthodox approach. Hence, according to JPF and FS, the EU's economic setting has been shaped on the assumption that the functioning of the free market and minor government interventions, limited to the removal of institutional distortions and "market failures," are sufficient conditions to pursue efficiency as the primary goal. This approach confines growth and full employment to the background. The two authors add that the main tools for the implementation of this economic governance are an independent central bank (the ECB) with a strict mandate for price stability, and weak fiscal policies "coordinated from the bottom" by means of centralised fiscal rules (CJE, p. 480).

My criticism of the analytical reconstruction by JPF and FS is that the economic framework characterising the euro area and completing the EU institutional setting requires neither the efficient market hypothesis nor the marginalisation of government interventions and the related recourse to structural reforms. The necessary and sufficient ingredients are two: (i) a central bank that pursues price stability in the area, independently of the fiscal disequilibria and the political constraints characterising each of the member states, and (ii) decentralised fiscal policies aimed at guaranteeing the sustainability of the national imbalances in the public budgets and current accounts through the combination of appropriate government initiatives and so-called "market discipline." To make a centralised and independent monetary policy compatible with decentralised fiscal policies, it is required that national policy makers are constrained to avoid opportunistic

behaviours. If national policy makers did not pursue fiscal rebalancing at the national level, price and macroeconomic stability would be threatened, and the ECB's decisions should be bound to implement a more restrictive monetary stance. Thus, the introduction of EU fiscal rules represents the main barrier against possible opportunistic behaviours and a consequent overlapping between national fiscal policies and monetary policy that would undermine the primary pillars of European economic construction.

As specified by Messori (2021), this EU institutional and economic framework is rooted in an old theory (ordoliberalism: see Eucken, 1950) that has little to do with neoliberalism. The analytical foundations of ordoliberalism are centred on the concept of the "market social economy." This concept stresses that the market and the state have complementary roles, and that this complementarity is key to effectively define market rules, state regulation, and social protection against market distortions.[1] Applying this setting to the EU and the euro area implies that national policy makers take full responsibility for managing government interventions and bringing national imbalances under control. In the first period of existence of the euro area before the international financial crisis, the new monetary union offered positive externalities so that the most fragile member states had external and internal resources to make investments enhancing their production activities and increasing their labour productivity. Conversely, with few exceptions, these same countries agreed with external investors to allocate a large part of their available resources to current spending and to strengthening rent-seeking positions (specifically, in real estate).

The result was a reproduction of macroeconomic imbalances (negative disequilibria in public balance sheets and current accounts). When the international financial crisis hit the EU economy, these imbalances

1. As emphasised by Fitoussi *et al.* (2010, pp. 253-54), Germany adopted a policy that was close to the neoliberal approach: the so-called Hartz reforms of the labour market (2003-2005). It should be noted, however, that these reforms were not implemented in the other most important member states of the euro area. For instance, in Italy the divide between incumbents with permanent employment contracts and new entrants with temporary or irregular employment contracts was never solved by means of regulatory initiatives. These national differences show that labour policy is not part of the EU's competences, but remains under the control of each member state. Hence, it would be questionable to maintain that the different labour policies implemented in various EU countries have been a crucial component of EU policies. There is, instead, empirical evidence that many of the national labour policies have had a common impact: a compression in the dynamics of monetary wages. Low monetary wages are one of the determinants explaining the inadequate processes of innovation and reorganisation implemented by EU firms relative to their US and Chinese competitors (see Buti and Messori, 2021a).

became unmanageable due to the “flight to quality” of external investors. The consequent “sudden stop” constrained the policy makers of the EU’s most fragile countries to activate short-term adjustments based on wage compression and aggregate demand reduction. It is in this context, which was also caused by the distortionary paths followed by national fiscal policy makers, that the implementation of structural reforms became a European leitmotif.

3. The lack of a policy mix

It is worth stressing that I am critical towards the EU’s institutional and economic construction based on the “market social economy.” This construction has implied that national fiscal policies in the EU did not aim at supporting aggregate demand and innovative productions within the single market. The stunted growth rate in the EU and – specifically – in the euro area from mid-2013 to the end of 2018 was mainly driven by net exports of manufacturing and a related negative gap of aggregate investment compared to aggregate savings. The European production model supported activities with robust but mature technologies, it did not favour investments at the technological frontiers, it confined services sectors to ancillary positions, and it did not extend the single market to include a European capital market. Moreover, EU construction based on the “market social economy” has justified the lack of centralised initiatives to ensure stability and the convergence of different member states within the area, to manage economic crises, and to implement financial regulation and supervision. These duties were instead attributed to national fiscal policies; however, being constrained by severe central rules, national policies were unable to play such a complex and active role.

These last observations show that, despite the inappropriate reference to Washington Consensus, the paper of JPF and FS correctly identifies some of the main weaknesses characterising the functioning of the EU economy. The two authors are right in stating that, in this area, “domestic demand is not considered… as an engine for growth,” decentralised fiscal policies are so constrained as to become “extremely passive,” and the “one-size-fits-all philosophy” dominates the adjustment’s rules (CJE, pp. 482-85). Moreover, JPF and FS have a formidable intuition in pointing out that “the combination of a monetary federation with a fiscal confederation cannot be stable” and “makes it

impossible to even conceive a policy mix" (CJE, pp. 494 and 480). However, while this intuition was something of a harbinger, the two authors were unable to fully exploit their crucial statement on the structural impossibility of an effective policy mix in the EU of the pre-pandemic period. In their view, the EU model was condemned to an irreversible deepening of policy constraints and to a rapid dismantling of social welfare. The rigid cage deriving from their incorrect identification of the EU economic architecture with neoliberal principles has driven JPF and FS to conceiving this area as unreformable. On the contrary, since the beginning of 2020, the EU's evolution testifies that this area has been able to handle the stalemate in its economic governance (2013-2020) and to define an effective (even if fragile) policy mix.

As understood in advance by JPF and FS, European institutions were unable to react to the euro area's "doom-loop" of 2010-2011 by implementing an appropriate policy mix. These institutions formally safeguarded the independence of central monetary policy from national fiscal policies, which is at the foundation of the ordoliberal principles, by strengthening the centralised fiscal rules ("Six pack", Fiscal Compact, "Two Pack") at the peak of the euro area recession (2011-2013). Consequently, in the EU aggregate, national fiscal policies intensified their pro-cyclical stance – or, at most, pursued a neutral stance – until the beginning of 2020. In the meantime, the ECB started a long phase of expansionary monetary policy (end of 2011 to mid-2012 and end of 2014 to end of 2018) by, first, exploiting the conventional tools up to the limit (LTRO), and then by implementing unconventional initiatives (OMT, T-LTROs, APPs). This distortionary policy mix led to a specific form of "fiscal dominance" or, even, "financial dominance" (see Benigno *et al.* 2023). The result was that the role of monetary policy was overburdened but, contrary to the expectations of JPF and FS, the EU economic architecture did not have to waive its main features (see Buti and Messori, 2021b).

The adaptability of the EU's economic framework which would not fit with its presumed neoliberal shape, finds solid empirical evidence in the institutional response to the pandemic impact. Since spring 2020, European institutions were able to launch an effective policy mix. The latter was based on an ultra-expansionary monetary policy centred on new emergency programmes that offered a safety net to the allocation of government bonds in the euro area financial markets, thus allowing

expansionary fiscal policies even in countries with a high public debt to GDP ratio. The main innovation of this policy mix was, however, the introduction of a Central Fiscal Capacity (CFC), even if limited to a "once and for all" implementation. The two initiatives, SURE and Next Generation – EU, represent the most important centralised fiscal programmes. The effective and positive impact of the new policy mix is suggested by the EU's unexpected ability to overcome the worst economic depression of the last two centuries in only a few quarters. The EU and euro area economies recorded an unexpected recovery from the second quarter of 2021 to the second half of 2022.

4. A few additional remarks

The policy mix, designed as a response to the pandemic shock, offers a positive methodological indication for the evolution of EU economic governance. Obviously, the stances of the different policy tools should depend on the economic phases, so that they cannot be always expansionary. At the same time, an effective policy mix must pursue different objectives, so that it can be effective to combine restrictions in some policies and expansions in others. Today, the persistence of the post-pandemic supply bottlenecks and of the war in Ukraine are strengthening the bilateral conflicts between the United States and China and are hindering the EU's export-led economic growth. To reproduce its significant role in the international market and to protect its socio-economic comparative advantages (a low environmental impact, an effective regulatory framework, and an extensive welfare state), the EU should implement dramatic changes in its production model by achieving the "green" and digital transitions and strengthening social inclusion.

These challenges cannot be supported mainly by a monetary policy facing excessive inflation rates and by national fiscal policies handling excessive disequilibria in their public balance sheets. They require a new European industrial policy and the production of European public goods (see Buti and Messori, 2023). In this perspective, the first steps in the construction of a European CFC represent an important improvement. It remains true that Next Generation – EU is a temporary solution, and it is worth stressing that the centralisation of financial resources to support national projects cannot be identified with a "fiscal federation." European industrial policies and European public

goods must be also based on centralised projects. However, current EU economic governance is far from a neoliberal setting. Hence, it is not necessary to rebuild the analytical pillars of this area. Significant improvements can be achieved by means of a more gradual approach.

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